–BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH–

IN THE MATTER OF THE INVESTIGATION OF REVENUE REQUIREMENT IMPACTS OF THE NEW FEDERAL TAX LEGISLATION TITLED: "AN ACT TO PROVIDE FOR RECONCILIATION PURSUANT TO TITLES II AND V OF THE CONCURRENT RESOLUTION OF THE BUDGET FOR FISCAL YEAR 2018"	)	DOCKET NO. 17-035-69 Exhibit No. DPU 1.0 DIR

FOR THE DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE
STATE OF UTAH

Direct Testimony of

William L Mecham

August 28, 2018

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1 # INTRODUCTION

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND TITLE.**

3 A. My name is Lane Mecham. My business address is 160 East 300 South, Salt Lake City,
4 Utah 84114. I am a Utility Analyst at the Utah Division of Public Utilities ("Division").

5

6 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

7 A. The Division's.

8

9 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

10 A. On December 22, 2017, the Act to Provide for Reconciliation Pursuant to Titles II and V
11 of the Concurrent Resolution of the Budget for Fiscal Year 2018 ("Tax Reform Act") was
12 signed into law. The Tax Reform Act made several significant changes to tax law,
13 primarily a reduction of the federal corporate income tax rate from 35% to 21%, which
14 significantly reduces the tax liability faced by Rocky Mountain Power ("the Company").
15 Additionally, it creates an adjustment to deferred income taxes that were previously
16 recorded on the books of the Company. Other changes impacting the Company include:

17 - a repeal of the domestic production activities deduction ("DPAD"),

18 - the repeal of the exclusion from income contributions in aid of construction
19 ("CIAC"),

20 • a requirement to normalize the excess deferred income taxes using the average
21 rate assumption method ("ARAM"), and

22 • changes to certain previously deductible expenses such as transit passes and
23 meals and entertainment expenses.

24 The Company has estimated the impact these changes will have on their revenue
25 requirement using an adjusted version of the December 31, 2017 Results of Operations.
26 The purpose of my testimony is to present the Division's recommendations for treatment
27 of these identified impacts.

28 **Q. YOU MENTION THAT ADJUSTMENTS WERE MADE TO THE DECEMBER**
29 **31, 2017 RESULTS OF OPERATIONS, WHAT ADJUSTMENTS WERE MADE?**

30 A. The Company took the December 31, 2017 Results of Operations and made several
31 changes ("Adjusted ROO") resulting in a baseline for determining the effects of the Tax
32 Reform Act. The most significant adjustment was estimated plant additions for 2018.
33 This adjustment, "included pro-forma adjustments to reflect all of the revenue
34 requirement components associated with all capital additions projected in 2018 consistent
35 with the effective period of the Tax Reform Act."[1] The Company also adjusted
36 allowance for funds used during construction (AFUDC) equity.

37 **Q. HOW DID THE COMPANY DETERMINE THE EFFECTS OF THE TAX**
38 **REFORM ACT USING THE ADJUSTED ROO?**

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[1] Direct Testimony of Steven R. McDougal, Docket No. 17-035-69, July 2018, Page 5, Lines 94-97.

39 A. The Company applied the Tax Reform Act changes to the Adjusted ROO then decreased
40 the revenues to an amount that held the return on equity constant with the Adjusted ROO
41 prior to applying the tax effects. The resulting difference is a decrease in the revenue
42 requirement.

43 **Q. IS THIS A REASONABLE METHOD FOR CALCULATING THE IMPACTS OF**
44 **TAX REFORM?**

45 A. Yes. However, the Division notes that amortization of Excess Deferred Income Taxes
46 ("EDIT") included with the Company's filing is for one year only and the actual amount
47 will vary by year. The amount of amortization for property related EDIT included in the
48 Company's filing is $20,470,344. The Division recommends using the average estimated
49 amortization for the periods 2018-2021 so that those variations are mitigated and passed
50 through to ratepayers until the next general rate case.

51 **Q. AS A RESULT OF TAX REFORM, WHAT IMPACTS WERE IDENTIFIED BY**
52 **THE COMPANY?**

53 A. The Company identified a Utah-allocated revenue requirement decrease of $92,303,432
54 and EDIT of $739,857,154. The decrease in revenue requirement consists of two
55 components: current taxes and EDIT amortization. Current taxes are estimated to reduce
56 by $65.9 million per year. The impact from amortization of EDIT for 2018 is $26.4
57 million. The EDIT is broken down into a "protected" category and a "non-protected"
58 category by IRS rules. "Protected" refers to rules requiring the Company to amortize
59 protected EDIT using the Average Rate Assumption Method or ARAM. Treatment of
60 "unprotected" is not governed by IRS rules. The Commission may choose to amortize

61 those balances using its own method. The unprotected EDIT is further broken down into
62 property-related EDIT and non-property EDIT. The following table shows the
63 breakdown of EDIT among these categories:

Excess Deferred Income Tax Balance as of December 31, 2017 ($ Thousands)	
EDIT Description	**Utah Allocated Balances**
Protected Property Related	$612,362
Non-Protected Property Related	$104,934
Non-Protected Non-Property	$22,561
Total	**$739,857**

64

65 **Q. HOW HAS THE COMPANY PROPOSED TO PASS THESE SAVINGS TO**
66 **RATEPAYERS?**

67 A. The Commission previously ordered the Company to pass $61 million of estimated tax
68 savings to ratepayers using Schedule 197. Now that impacts of tax reform are more
69 certain, the Company estimates current taxes will decrease by $65.9 million.
70 Additionally, the Company estimates amortization of EDIT as it proposes will have a
71 $26.4 million revenue requirement decrease in 2018. These two amounts combined are
72 $92.3 million which is $31.3 million more than is currently being passed through to
73 ratepayers through Schedule 197. The Company proposes to defer this additional $31.3
74 million as a regulatory liability to offset future upward pressures on rates. Included in the
75 $92.3 million revenue requirement decrease is property related EDIT amortization (both
76 protected and non-protected) of $20.5 million. The Company proposed the remaining
77 non-protected non-property balance of EDIT totaling $22,560,698 be amortized over a 5
78 year period beginning after the next general rate case.

79 **DIVISION RECOMMENDATIONS**

80 **Q. DOES THE DIVISION AGREE WITH THE APPROACH RECOMMENDED BY**
81 **THE COMPANY?**

82 A. No. The Division recommends different treatment for current taxes, protected EDIT, and
83 non-protected EDIT.

84 **CURRENT TAXES**

85 Rates should be based on the current costs of serving customers, as nearly as practicable.
86 Ongoing tax expense has been reduced and rates should reflect this reduction. The
87 Company estimates taxes will be reduced by $65.9 million per year, which is $4.9 million
88 more than the $61 million currently being passed through to ratepayers via Schedule 197.
89 This reduction in ongoing tax expense should reduce rates until completion of the next
90 general rate case. The Division recommends revising Schedule 197 to flow back the full
91 $65.9 million to ratepayers effective January 1, 2019. In 2019, the $4.9 million that was
92 not refunded to ratepayers in 2018 should be included as well. This would pass through
93 $70.8 million in 2019, and $65.9 million each year thereafter until completion of the next
94 general rate case.

95 **PROTECTED EDIT**

96 Protected property related EDIT is subject to ARAM rules and cannot be amortized using
97 another method without consequences that would not be beneficial to ratepayers. The
98 Company calculated the impact protected property related EDIT will have on 2018,
99 however, the amount of actual amortization fluctuates significantly from year to year.
100 The Division recommends averaging the amortization for the period 2018-2021 so that

101 fluctuations in the amortization are captured and passed through to ratepayers. The
102 Company provided these amounts in response to Office of Consumer Services' data
103 request number 5.4 though it has not been updated since the August 2nd "Update to
104 Filing," which changed the amount of protected and non-protected property related
105 EDIT. The Division requested the Company provide updates to this information and the
106 Division will include these updated amounts in its subsequent testimony filings.

107 **NON-PROTECTED EDIT**

108 The non-protected property related EDIT balance is $104.9 million and the non-protected
109 non-property EDIT balance is $22.6 million for a combined total of $127.5 million.
110 These balances are not subject to ARAM rules, which allows the Commission to dispose
111 of these balances at its discretion. The Division recommends these balances be adjusted
112 up for the current tax effect and amortized over a 10 year period. This results in an
113 annual amortization of $17 million. This is computed by multiplying the $127.5 million
114 of non-protected EDIT by the gross up factor of 1.333 provided in the Company's
115 workpapers for a total of $170 million, then dividing this total by 10 for the amortization
116 period. The Division proposes to begin amortizing this balance effective January 1,
117 2019, using Schedule 197.

118 The Division recommends this treatment because using the ARAM method to amortize
119 the property related portion would push the tax reform savings far out into the future and
120 away from the ratepayers who generated the deferred income tax balance now being
121 returned. Waiting until some uncertain future time to create an uncertain mechanism to
122 return these funds is not in the public interest. It would needlessly complicate rates,

123 requiring more tracking and likely a new mechanism. Furthermore, the Division believes
124 its proposal creates a simpler, more transparent regulatory process for all parties.
125 Amortizing the balance will still effectively offset rate increases as they happen but won't
126 require an additional filing to offset regulatory assets for unknown future costs. Rates will
127 more closely reflect the cost of providing the service and minimize generational
128 inequities.

129 **Q. WHAT COMMENTS DO YOU HAVE REGARDING THE CREDIT RATING OF**
130 **THE COMPANY BEING AFFECTED BY THE COMMISSION' S DECISION?**

131 A. The Division acknowledges a favorable credit rating is beneficial to ratepayers through
132 lower borrowing costs, however, the Company has not demonstrated that its credit rating
133 will be affected by the Commission's decision in this Docket. The Company has cited
134 reports that show some impacts of Tax Reform on the Industry, such as the Brattle Group
135 Tax Report and a report from Moody's, however, they fail to show that PacifiCorp
136 specifically will be adversely impacted with a ratings downgrade. In fact, in confidential
137 Exhibit RMP__(NLK-1), which is the June 22, 2018 credit opinion issued by Moody's
138 for PacifiCorp, Moody's says,
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[2] Moody's Investors Service, Credit Opinion, June 22, 2018, Page 1.

144 [redacted]

145 [redacted] Its recent dividend

146 declaration also suggests the PacifiCorp overstates this concern.

147 The Division also believes, despite the benefits to ratepayers of a favorable credit rating,
148 the Company is not guaranteed a specific credit rating and it would be inappropriate to
149 try to do so. Generally speaking, a financially healthy utility is one that can recover its
150 prudently incurred costs in addition to a competitive return on its investment, which the
151 Company has been successful at doing for several years as shown in its results of
152 operations filings. Choosing to defer tax savings away from the ratepayers who initially
153 paid in to create those balances in order to preserve a credit rating that hasn't been shown
154 to be at risk would be inappropriate.

155 **Q. THE COMPANY BELIEVES ITS PROPOSAL WILL PROVIDE RATE**
156 **STABILITY, DO YOU HAVE ANY COMMENTS ON THIS?**

157 A. The Division agrees that gradualism and rate stability are important ratemaking
158 principles. It also believes that rates should be based on costs. The reduction in annual
159 taxes should be passed through to ratepayers and not deferred because ongoing tax
160 expenses have been reduced. As the Division noted in the first phase of this docket,
161 charging customers today for future costs which are not yet known is inappropriate.
162 Furthermore, it is not certain that delay will promote rate stability. In fact, the future is
163 unpredictable and numerous ratemaking components might move in different directions.
164 Trusting our knowledge of the future to retain incorrect rates today is unwise. As for
165 treatment of the EDIT balances, the Division's recommendations will still create an offset

166 to future rate increases if they occur, and they will do so without creating additional
167 regulatory burdens and complexity.

168 CONCLUSION

169 **Q. COULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?**

170 A. The Division recommends the Commission order the Company to refund $70.8 million
171 effective January 1, 2019, through schedule 197 and $65.9 million effective January 1,
172 2020, and every year thereafter until the completion of the next general rate case. It also
173 recommends the Commission order the Company to use the average ARAM amortization
174 of protected property related EDIT for the period 2018 – 2021 and begin refunding that
175 amount effective January 1, 2019, through Schedule 197. Lastly, it recommends the
176 Commission order the Company to adjust non-protected EDIT balances for the current
177 tax effects (gross up balances) and refund those balances to ratepayers over a 10 year
178 period, effective January 1, 2019, using Schedule 197. Below is a summary of the
179 Division's recommendations.

Summary of Schedule 197 Refund Balances					
Non-Protected EDIT		**Utah Allocated EDIT**	**Gross Up Factor**		**Grossed Up EDIT**
Property Related	$	104,934,317	1.333	$	139,893,981
Non-Property	$	22,560,698	1.333	$	30,076,966
Total	**$**	**127,495,015**	**1.333**	**$**	**169,970,947**
Annual Amortization of Non-Protected EDIT (10 Years)				$	16,997,095
Annual Amortization of Protected EDIT (ARAM)*				$	16,002,940
Annual Reduction in Tax Expense				$	65,890,414
Total Annual Credit through Schedule 197**				$	98,890,449

*This amount represents the average amortization for the years 2018-2021 which will be updated in rebuttal testimony with an update to OCS data request 5.4.
**2019 will have an additional $4.9 million for the amount not refunded in 2018.

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181 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

182 A. Yes, it does.